

## Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

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Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:04

PLR-107217-13

Date:

August 06, 2013

RE:

Trust =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Date 6 =

Date 7 =

Grantor =

Son =

Adopted =

Children

(Adopted

Child,

individually)

Court =

State Statute =

1

State =

Dear :

This letter responds to your authorized representative's letter dated February 1, 2013 requesting a ruling on the generation-skipping transfer (GST) tax consequences of a settlement agreement and judicial construction of a trust.

The facts submitted and the representations made are as follows: On Date 1, a date prior to September 25, 1985, Grantor created and funded Trust, an irrevocable trust. Under Article 2 of Trust, the trustees must pay to charitable organizations described in §§ 501(c)(3), 170(c), and 2522(a) of the Internal Revenue Code (Code) the entire net income of Trust until the earlier of Date 7 or the death of the last to survive of Grantor's six children and eleven grandchildren who were living on Date 1. Thus, on such date, Article 3 instructs the trustees to divide Trust into as many equal shares as there are living grandchildren of Grantor, and for any deceased grandchild of Grantor, an equal share for the collective issue of the deceased grandchild. Any share created for the collective issue of a deceased grandchild will be distributed outright in equal shares, per stirpes. The shares created for each living grandchild of Grantor will be held in an Individual Family Trust for that grandchild as beneficiary.

Article 3, paragraph B provides that the trustees of each Individual Family Trust may make discretionary distributions of principal and net income to the beneficiary, the beneficiary's parents or guardian, spouse, or issue. Upon the beneficiary's death, and subject to a testamentary special power of appointment held by the beneficiary, the trustees are directed to distribute all of the assets of the Individual Family Trust outright to the issue of the beneficiary, per stirpes, or if there are no living issue of the beneficiary, then to the persons (excluding Grantor) who would be entitled to inherit from the beneficiary under state law if such beneficiary had died intestate in State, or if no such persons are living, then to organizations described in §§ 170(c), 501(c)(3), 2055(a), and 2522(a) of the Code. Paragraph C of Article 3 provides that all trusts created under Trust will terminate on the death of the last to survive of the six children and eleven grandchildren of Grantor who were living on Date 1. Paragraph C also provides that,

[t]he terms "children" and "issue" as used in this Trust shall be construed to include an adopted child or children . . . , provided, however, that if any person adopts more than two (2) children who would qualify as "children" or "issue" as used herein, the adopted children of such person in excess of two (2) adopted children (in the order of date of adoption) shall not be construed to be "children" or "issue" as used herein.

Under Article 4, if any person is under the age of twenty-one when such person becomes entitled to a share of Trust, the trustees will hold the share in trust, subject to discretionary distributions for such person's benefit, until such person attains twenty-one years of age. However, if such person dies before attaining twenty-one years of age, the share will be distributed outright to the persons (excluding Grantor) who would be entitled to inherit from such person under state law if such person had died intestate in State, or if no such persons are living, then to organizations described in §§ 170(c), 501(c)(3), 2055(a), and 2522(a) of the Code.

On Date 2, Son, one of Grantor's six children, simultaneously adopted Son's four step-children. Adopted Children realized that under the terms of Paragraph C of Article 3, all of the Adopted Children may not be considered remaindermen of Trust. On Date 3, Adopted Children executed a binding agreement (Date 3 Agreement). Under the Date 3 Agreement, in consideration for any claim each Adopted Child or the Adopted Child's issue may have to a greater share of or interest in Trust and to preserve family harmony, each Adopted Child agreed that the two shares of Trust that Adopted Children would be entitled to under Article 3 paragraph C, if living upon termination of Trust, would be divided equally among living Adopted Children and the issue, per stirpes, of a deceased Adopted Child.

State Statute 1 provides that a trustee may request that a court determine any question arising in the administration of a trust, including a construction. On Date 4, the trustees of Trust petitioned Court to construe Trust and confirm plan for Individual Family Trust funding on Date 7. On Date 5, Court held a hearing on the matter. On Date 6, consistent with the Date 3 Agreement, Court ordered that on Date 7, trustees establish four Individual Family Trusts, one for each Adopted Child, and fund each of the four Individual Family Trusts with one-half of the asset value of the Individual Family Trusts created for Grantor's other grandchildren. The Court also stated that the order would not be effective until the trustees obtain a favorable private letter ruling from the Internal Revenue Service.

The trustees of Trust have represented that there have been no additions to Trust after September 25, 1985. You have asked for a ruling that the Date 3 Agreement and Court's judicial construction of Trust in the Date 6 order will not affect the GST exempt status of Trust.

Section 2601 imposes a tax on every GST. A GST is defined under § 2611(a) as: (1) a taxable distribution; (2) a taxable termination; and (3) a direct skip.

Section 2612(a)(1) defines the term "taxable termination" as the termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in a trust unless – (A) immediately after the termination, a non-skip person has an interest in the property, or (B) at no time after the termination may a distribution (including distributions on termination) be made from the trust to a skip person. Section 2612(b) defines the term "taxable distribution" as any distribution from a trust to a skip person (other than a taxable termination or a direct skip). Section 2612(c)(1) defines the term "direct skip" as a transfer subject to the federal estate and gift tax of an interest in property to a skip person.

Section 2613(a) provides that the term "skip person" means (1) a natural person assigned to a generation which is 2 or more generations below the generation assignment of the transferor, or (2) a trust in which all interests are held by skip

persons, or (3) a trust where no trust distributions, including those upon termination, may be made to a non-skip person.

Section 26.2601-1(a)(1) of the Generation-Skipping Transfer Tax Regulations provides that except as otherwise provided in § 26.2601-1(a), the provisions of chapter 13 of the Code apply to any generation-skipping transfer made after October 22, 1986.

Under § 1433(b)(2)(A) of the Tax Reform Act of 1986 and § 26.2601-1(b)(1)(i), the GST tax provisions do not apply to any GST trust (as defined in § 2652(b)) that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added).

Section 26.2601-1(b)(1)(iv) provides that if an addition is made after September 25, 1985, to an irrevocable trust which is excluded from chapter 13 by § 26.2601-1(b)(1), a pro rata portion of subsequent distributions from (and terminations of interests in property held in) the trust is subject to the provisions of chapter 13.

Section 26.2601-1(b)(4) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the generation-skipping transfer tax under § 26.2601-1(b)(1), (b)(2), or (b)(3) will not cause the trust to lose its exempt status. The rules of § 26.2601-1(b)(4) are applicable only for purposes of determining whether an exempt trust retains its exempt status for generation-skipping transfer tax purposes. They do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of capital gain for purposes of § 1001 of the Code.

Section 26.2601-1(b)(4)(i)(B) provides that a court-approved settlement of a bona fide controversy regarding the administration of the trust or the construction of terms of the governing instrument will not cause an exempt trust to be subject to the provisions of chapter 13, if – (1) the settlement is the product of arm's length negotiations, and (2) the settlement is within the range of reasonable outcomes under the governing instrument and applicable state law addressing the issues resolved by the settlement. The regulations further provide that a settlement that results in a compromise between the positions of the litigating parties and reflects the parties' assessments of the relative strengths of their positions is a settlement within the range of reasonable outcomes.

In this case, Trust was irrevocable on September 25, 1985, and the trustees have represented that there have been no additions to Trust after September 25, 1985. The factual situation presented, that is the simultaneous adoption of four children by Son, creates a bona fide issue regarding the administration of Trust and the construction of the terms of Trust. The Date 3 Agreement between Adopted Children

and the subsequent Date 6 Court order resolve the issue. The Date 3 Agreement is a product of arm's length negotiations representing a compromise that reflects the parties' assessments of the relative strengths of the positions of the various parties, and is within the range of reasonable outcomes under the governing instrument and applicable state law. Based on the facts presented and the representations made, we conclude that the requirements of § 26.2601-1(b)(4)(i)(B) are satisfied and Trust will not lose its GST exempt status.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

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James F. Hogan  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosure: Copy for § 6110 purposes